State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Monthly Meeting April 28, 2010

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, April 28, 2010. The Treasurer called the meeting to order at 9:07 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Thomas Fay, Mr. Robert Gaudreau, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Frank T. Caprio, establishing a quorum. Also present were: Ms. Sally Dowling, of Adler Pollock, & Sheehan, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; Ms. Michelle Davidson of Pacific Corporate Group, Ms. Lisa Tyrrell and Mr. Nick Katsikis of State Street Corporation; and members of the Treasurer's staff. Dr. Robert McKenna was not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of February 24, 2010. Mr. Reilly moved, Mr. Costello seconded, and the subsequent motion passed. The following members voted in favor: Ms. Gallogly, Mr. Costello, Mr. Fay, Mr. Gaudreau, Mr. Giudici, Ms. Reback, Mr. Reilly and Treasurer Caprio.

VOTED: To approve the Minutes of the March 24, 2010 monthly meeting.

General Consultant Report. Mr. Burns stated that the General Consultant Report is going to be handled by Mr. Goodreau today.

Treasurer Caprio asked Ms. Michelle Davidson of Pacific Corporate Group to provide a presentation on the secondary sale opportunity.

Secondary Opportunity Review. Ms. Davidson stated that at last month's meeting, we discussed consideration of a secondary sale of private equity interests and approved evaluating the options. The primary driver is allocation, as at year end private equity was significantly over allocated at 10.1% of the portfolio, versus the policy, which is 7.5%, which made it difficult to consider new investments. This transaction would immediately drop the allocation by about 2%, which would put the allocation in a normal tolerance range. Additionally, by selling some funds you would get a large cash in-flow, and then the portfolio would likely remain cash positive. Over time, the proceeds can be redeployed into strategies, managers, and vintage years that are more attractive given the current environment. This allows a rebalancing of the portfolio, which given the long term contracts in private equity, is otherwise difficult to do. One reason why rebalancing can be important is the cyclicality of private equity returns. Ms. Davidson asked the commission to refer to a graph in

the presentation which showed returns of the industry and the portfolio over time, and noted immediately there is a lot of variation by vintage year. When you deploy capital is very important; it is really a factor of the economy as well as the flows of capital into private equity. In the current environment, you can typically buy companies cheaper, as you can buy at lower multiples of depressed earnings, so if you redeploy money with managers now, most likely you will be able to achieve better returns than over the last few vintage years.

There are several mitigating factors to the concerns expressed last month of giving away upside and taking a large discount. Redeploying the proceeds into currently attractive strategies helps to negate any upside concession, and with the sale proceeds on the transaction plus the collected distributions on these funds, there will be an effective gain. The way the overall transaction is structured the portfolio realizes this gain on the funds. Further, given the time value of money, selling now with a low discount offsets waiting for future distributions. The timing of this transaction will effectively catch the peak with a single digit discount which was unprecedented until now; even a few months ago discounts were as high as 50%. This proposal is to sell ten funds, with four managers, to three buyers in order to get the best pricing for the fund. With this structure the blended discount will be 8.6% giving sales proceeds of about $82 million. Combining the sale proceeds with the $120 million of distributions received there is a total value of about 1.2 times on the investment capital. No intermediaries will be used on this transaction, so the fund

will not pay any fees or commissions, which will result in savings on commissions of just over $3 million, and that's going to drop to the bottom line on the transaction.

The board discussed the rationale of the sale and various aspects of the transaction.

Ms. Booth Gallogly asked if the actual funds would be willing to reduce our commitment at no discount.

Ms. Davidson explained how occasionally that happens, but generally only if it's driven by a very large investor, and because of most favored nations clauses they have to offer that to all investors. Given the size of the large buyout funds, there would not be enough leverage to negotiate a commitment reduction, and you are effectively already getting one hundred percent of the value on the unfunded portion of your commitment on this type of transaction.

Mr. Costello asked for clarification on the fund's returns and if the sale is for strategic allocation and what due diligence was done on the values for this proposed transaction.

Ms. Davidson stated that 1.2x is the return and that allocation is the driver on this sale. These funds are monitored on an ongoing basis including daily cash flows, and we are monitoring the value information and methodologies and comparing that to other general partners that may be in the same transactions. In this case we evaluated the values of the funds versus the bidders' proposals, and we spoke to each general partner to get a sense of future distributions.

Mr. Fay asked for clarification on the objective of the sale.

Ms. Davidson stated that the primary driver is to reduce allocation; however you are accomplishing three objectives: reducing the private equity allocation, rebalancing, which included reducing exposure to buyouts, and receiving a favorable price.

Ms. Booth Gallogly stated that it is our responsibility to ask the GP to buy our commitment.

Mr. Goodreau commented that the main objective is to bring the allocation back to policy at 7.5% of the total plan assets. As fiduciaries if we don't do this transaction we either have to change the policy or say it is acceptable to be dramatically overweight in the space. Mr. Reilly stated that we are getting full credit for the unfunded commitments so the pricing is based on NAV. So if the GP takes it back or if a buyer takes it - it is 100% gone for us and we will reduce the allocation with the sale.

Mr. Goodreau said that there is a choice A and choice B: either do it or not do it. There isn't a choice C, none of the above. Because we are outside of the policy, so we have to change the policy if we are comfortable being at a 10 % allocation, or take steps to bring the allocation within policy.. Not voting for the sale is a vote for a policy change or acceptance of a violation

The group then discussed the current view of the market focusing on private equity as it relates to the potential sale.

Mr. Fay mentioned that coming back to policy and reducing the overweight to large buyouts makes complete sense from a strategic stand point. He asked if liquidity is back in the market such that this is the time to sell.

Ms. Davidson said that about a year ago prices were 50 % of asset values.
Mr. Goodreau remarked that it is important to recognize there have been few times in history that you see single digit discounts even when we are not coming out of a credit disaster. We caught a very good time. We got a single digit discount, and literally 3 months earlier we were looking at a 30 to 40% discount.
Mr. Reilly commented that he agreed, that he didn’t think that 91.4 % was achievable. He thought that about 12.5 to 13 % discount was the best we can do on a blended basis.

Treasurer Caprio entertained a motion to approve the secondary sale as presented by Ms. Davidson of PCG to rebalance the allocation of the private equity portfolio and proceed with sale of the option 1, of 10 funds, at a blended basis of no more than an 8.6% discount to the proposed bidders. The following members voted in favor: Mr. Costello, Mr. Fay, Mr. Gaudreau, Mr. Giudici, Ms. Reback, Mr. Reilly and Treasurer Caprio. The following member voted against: Ms. Gallogly.

VOTED: To approve the secondary sale as presented by Ms. Davidson of PCG to rebalance the allocation of the private equity portfolio and proceed with sale of option 1, of 10 funds, at a blended basis of no more than an 8.6% discount to the proposed bidders.

Legal Counsel Report. Legal Counsel had no report.

Chief Investment Officer Report. Mr. Goodreau reported that we continue to explore hedge fund of funds, and that the initial goal was to determine if an alternative in the portfolio would reduce the standard deviation. A formal invitation only search was issued to approximately 30 of the largest institutional firms that deal with state pensions. The first phase, which is quantitative, reviewing the response data; including performance, underlying managers, verifying proper registration was lead by Brockhouse Cooper. We are now in the qualitative phase where we will review: age of the firm, employee turnover, and similar client base. We will likely conduct one or more site visits. This may be a good time to get a sub-committee together to review the best firms with the consultants and to make a report to the full board.

Mr. Goodreau commented that over the past couple of years we have gone through one of the toughest times for investing in the country's history. The board has made some difficult decisions during that time. We have a policy benchmark, and our job as a board, as fiduciaries, is to be prudent and our secondary goal is to increase performance versus our benchmark. For the first time the RI program is out-performing its benchmark in every average time period. Decisions that the board made over the past two years ago are now starting to filter into our longer term numbers. One of our other mandates is to get the best risk adjusted rate of return possible. In the past our standard deviation, our measure of volatility and risk, was consistently over 12.5% and consistently over our benchmark.

Our standard deviation right now is 11.28%, while our standard deviation for our benchmark is 12.25%. So we have reduced our standard deviation or volatility by almost a full point. We are beating our benchmark, we have reduced risk and we have reduced fees between $12 and $15 million on an annualized basis. All of these factors have led to out-performance.

Treasurer's Report. Treasurer Caprio stated that last month he reported on the Treasury & RIHEAA staff's negotiations with Alliance Bernstein on the 529 plan renewal. He called on Mr. Dingley to give an update on the Alliance Bernstein contract.

Mr. Dingley said that the substantive issues have been agreed upon and now the lawyers are reviewing the 30 page revised contract. Alliance representatives should make a presentation here next month.

Treasurer Caprio commented that the major point is that RI families participating in the 529 plan will get absolute lowest fees nationally.

Mr. Dingley noted that another new feature is that a $100 contribution will be made for every new baby born in RI so they will start out with $100 in their college savings account.

Treasurer Caprio commented that there have been a lot of discussions about public pensions in RI in which the Treasurer's office has been active . The RI House and Senate passed changes but they did not become law yet this year because they differed. As discussions continue the staff will continue to provide information and the Treasurer will keep the SIC informed.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Ms. Reback moved, Mr. Giudici seconded and the subsequent motion passed. The following members voted in favor: Ms. Gallogly, Mr. Costello, Mr. Fay, Mr. Gaudreau, Mr. Giudici, Ms. Reback, Mr. Reilly and Treasurer Caprio.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 9:58 a.m.

Respectfully submitted,

Frank T. Caprio
General Treasurer